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FINANCIAL REPORT

1940

To the Stockholders of

The

NATIONAL TOOL COMPANY

CLEVELAND, OHIO

THE NATIONAL TOOL COMPANY

11200 MADISON AVENUE

CLEVELAND, OHIO

Directors

A. J. Brandt
J. Victor Loewi
L. A. Schmidt
L. F. Jubenville
S. J. Kornhauser
P. F. Zerkle
John S. Pearson

Officers

A. J. Brandt	*President*
L. A. Schmidt	*Vice-Pres.*
P. F. Zerkle	*Vice-Pres.*
S. J. Kornhauser	*Secretary*
L. M. Prosser	*Treasurer*
L. M. Shafer	*Asst. Sec. & Treas.*

Transfer Agent

The National Tool Co.

11200 Madison Ave. Cleveland, Ohio

REGISTER

Central National Bank

308 Euclid Ave. Cleveland, Ohio

INTRODUCTION

The Annual Report of your company has been prepared, to give you an understanding of the past year's operations. In order to give those stockholders who have never visited our plant a better understanding of our products, there has been included in this report several pictures of our products and facilities for manufacturing.

SALES

Net Sales for 1940 were $1,187,895, an increase of 59.8 over the previous year. Thru continued concentration upon quality and diversification of our products, we now enjoy the confidence of nearly 1,000 regular customers who demand National Tool Products. Our company is considered a very vital part of the National Defense Program. Proof of this is that we are now being favored with substantial contracts covering our regular tool line. The improvement in business generally should further increase our Sales Volume during 1941.

EARNINGS

Net profit for year 1940 amounted to $82,620. after all charges, including $25,000 set aside as a reserve for Federal Income Taxes. This compares with a loss of $5,100 for the year of 1939.

Profits were equivalent to 40c per share on the 204,130 shares of common stock outstanding.

TAXES

Taxes paid during 1940 amounted to $32,576 divided between—

Real and Personal Property	$8,467
Capital Stock Tax	1,616
State Franchise Tax	245
Social Security Tax	5,598
Unemployment Tax	16,650

FINANCIAL

To improve our facilities, new equipment costing $42,759 was installed during the year and $7,842 was spent on motorizing old equipment.
Working capital increased from $113,659 on December 31, 1939 to $182,417 on December 31, 1940.
Since May 1, 1937, $310,130 has been expended on new equipment exclusive of $57,951 representing appropriations for equipment now in process of completion.
Your company's land, buildings and equipment including appropriations in process are carried on the books at a net figure of $330,302.
During the year $19,000 of 6% convertible debentures were acquired for retirement.
During the year these 31,507 shares of common stock sold for $64,082 to provide necessary Working Capital.

LABOR RELATIONS

Relations with our employees have been maintained on a very satisfactory basis during the past years. The Board of Directors wish to thank each and every employee for this loyalty and cooperation. We hope the mutual trust and confidence which has been responsible for this happy relationship may always continue.

MISCELLANEOUS

Shipments and net profit for the first two months of 1941 were on a considerably higher level than any month in 1940, with indications that the improvement will continue, although it is impossible to accurately estimate at this time what percentage of net will be absorbed by taxes.
At the close of 1940 the company's stock was held by more than 1200 shareholders.
The Management is devoting its energies toward keeping abreast of developments in the industry and adapting itself to the needs of its customers. It is constantly on the alert for new products to supplement its existing lines.

THE NATIONAL TOOL COMPANY

Board of Directors

ANALYSIS OF SALES DOLLARS

During the Year Ended December 31, 1940—

		Amount	Percent of Sales
We took in:			
For goods billed customers		$1,186,061.67	
For miscellaneous items		1,978.73	
		1,188,040.40	100.
We paid out:			
For Materials		214,344.35	18.
For Wages		660,793.69	55.6
For Taxes—		59,562.73	5.
Provision for Income Tax	25,000.00		
Social Security Tax	23,618.20		
Property & Real Tax	8,512.29		
Corporate Tax	2,068.41		
Sales Tax	363.83		
For Insurance		4,575.66	.4
For Depreciation		23,997.29	2.
For Tools		32,780.90	2.8
For Power, Heat, Light & Water		18,555.85	1.6
For Equipment Repairs		10,844.73	.9
For Traveling Expense		25,919.82	2.2
For Interest Paid on Borrowed Money		11,656.64	1.0
For Misc. Expense, Telephone, Telegraph, Postage, Stationery, Professional Services, Royalties, Bond Expense, etc.		42,388.48	3.6
		1,105,420.14	
Retained for Working Capital		82,620.26	6.9
		1,188,040.40	100.

SUMMARY OF PROFIT AND LOSS STATEMENT

THE NATIONAL TOOL COMPANY

Year ended December 31, 1940

Net sales		$1,186,061.67
Cost of products sold		868,535.32
GROSS PROFIT		$317,526.35
Expenses:		
Selling	$143,773.16	
General and administrative	53,115.38	196,888.54
OPERATING PROFIT		$120,637.81
Other income:		
Discount on bonds purchased for retirement		1,005.00
Sundry		973.73
		$122,616.54
Other deductions:		
Interest on funded debt	$ 11,421.49	
Interest on notes and accounts	235.15	
Amortization of bond discount and expense	3,063.48	
Sundry	276.16	14,996.28
PROFIT BEFORE TAXES ON INCOME		$107,620.26
Provision for federal taxes on income—estimated:		
Normal income tax		25,000.00
NET PROFIT		$ 82,620.26

Provision for depreciation included above—$23,997.29

March 12, 1941

Board of Directors,
The National Tool Company,
Cleveland, Ohio.

We have examined the balance sheet of The National Tool Company as of December 31, 1940, and the statements of profit and loss and surplus for the year then ended, have reviewed the system of internal control and the accounting procedures of the Company and, without making a detailed audit of the transactions, have examined or tested accounting records of the Company and other supporting evidence, by methods and to the extent we deemed appropriate.

During the year the Company sold 29,370 shares of common stock at $2.00 a share to an underwriter and 2,000 shares to an officer at $2.50 a share. The shares sold to the officer were part of certain shares which were under option to him. At a meeting of the executive committee on June 26, 1940, the officers of the Company were authorized to purchase, from the aforementioned underwriter, 4,000 shares of stock at $2.35 per share; such shares to be sold to employees at the purchase price subject to refunds of amounts (less than full subscription price) reserved or applied on subscriptions in the event of employees dismissal or death. The subscription price is payable monthly by the employee through the application of the monthly volume bonus. In addition to the foregoing, 120 shares previously reserved and subscribed for, were fully paid and issued during the year and of 67 additional shares subscribed for at $2.50 per share 17 shares were fully paid and delivered and partial payments aggregating $100.00 were received on the 50 shares undelivered.

Trade accounts receivable were tested by communication with the debtors. Inventory quantities of finished goods, raw materials and supplies are based on continuous book records which were adjusted to counts, weights or measurements made by employees of the Company during the latter part of the year. Quantities of work in process and scrap steel were counted or weighed by employees of the Company on December 31, 1940. We observed procedures followed in the determination of quantities of work in process and scrap and made tests of the continuous records of other items by comparison with the test counts made by us. Raw steel, work in process and finished products were priced on the basis of standard costs which have been reduced to estimated actual costs through the provision of a reserve. Other items are priced at the lower of cost or market with the exception of a machine previously manufactured for sale which was priced at estimated realizable value. We tested the computations and basis of pricing as outlined above. Reference is made to comments hereinafter set forth with respect to rock bit materials included in the inventories.

Property, plant and equipment accounts are included in the balance sheet on the basis of cost as shown by the records of a predecessor company, with subsequent additions at cost and less reserves for depreciation. The principal charges made to these accounts during the year were substantiated through the examination of data on file. In August, 1940, the Company changed its policy to include approximately $10,000.00 of manufacturing expenses in costs of machines built to be used by the Company. Previously the Company capitalized only labor and material costs of such items.

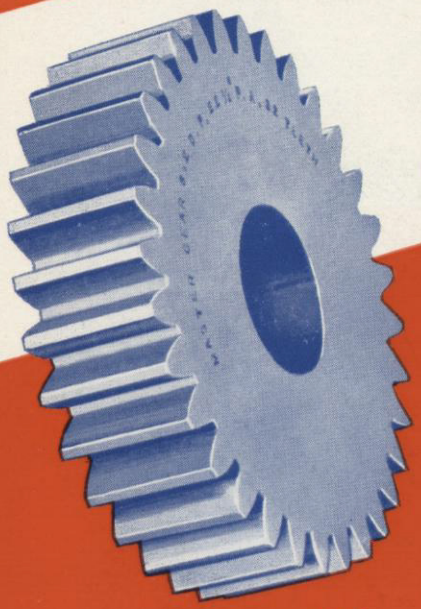
NATIONAL Tools CLEVELAND

SERVING AMERICAN INDUSTRY

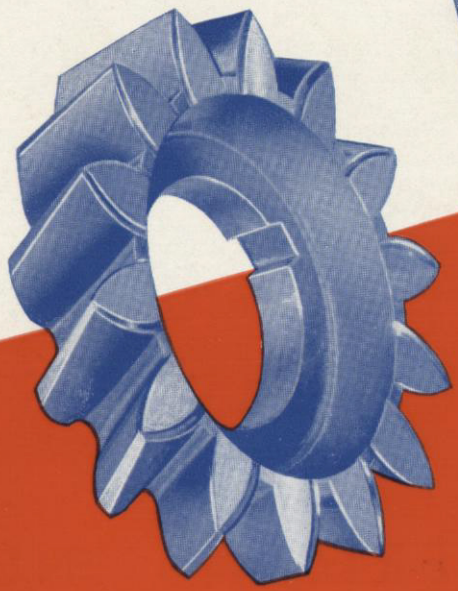
FOR MORE THAN TWO GENERATIONS

THE NATIONAL TOOL COMPANY
11200 Madison Ave. Cleveland, Ohio

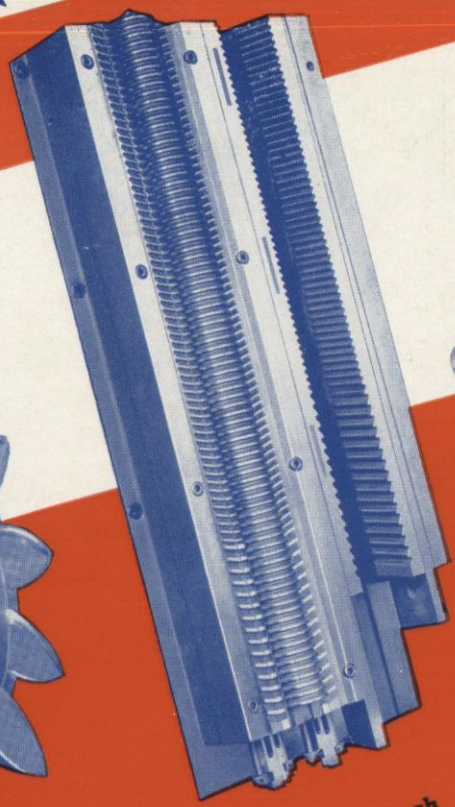
NATIONAL Tools CLEVELAND



Master Gear



Herring Bone Cutter

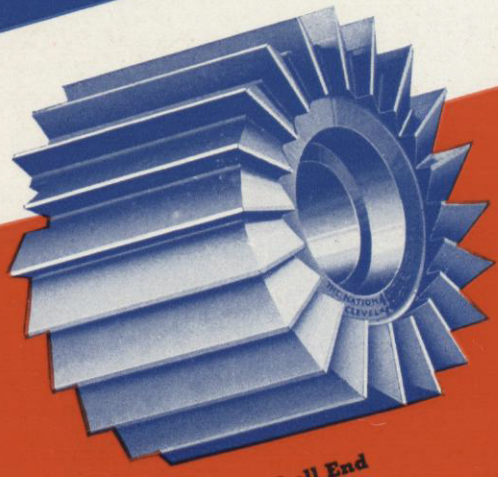


Surface Broach

Spurg Shaper

TOOLS THAT SPEED THE

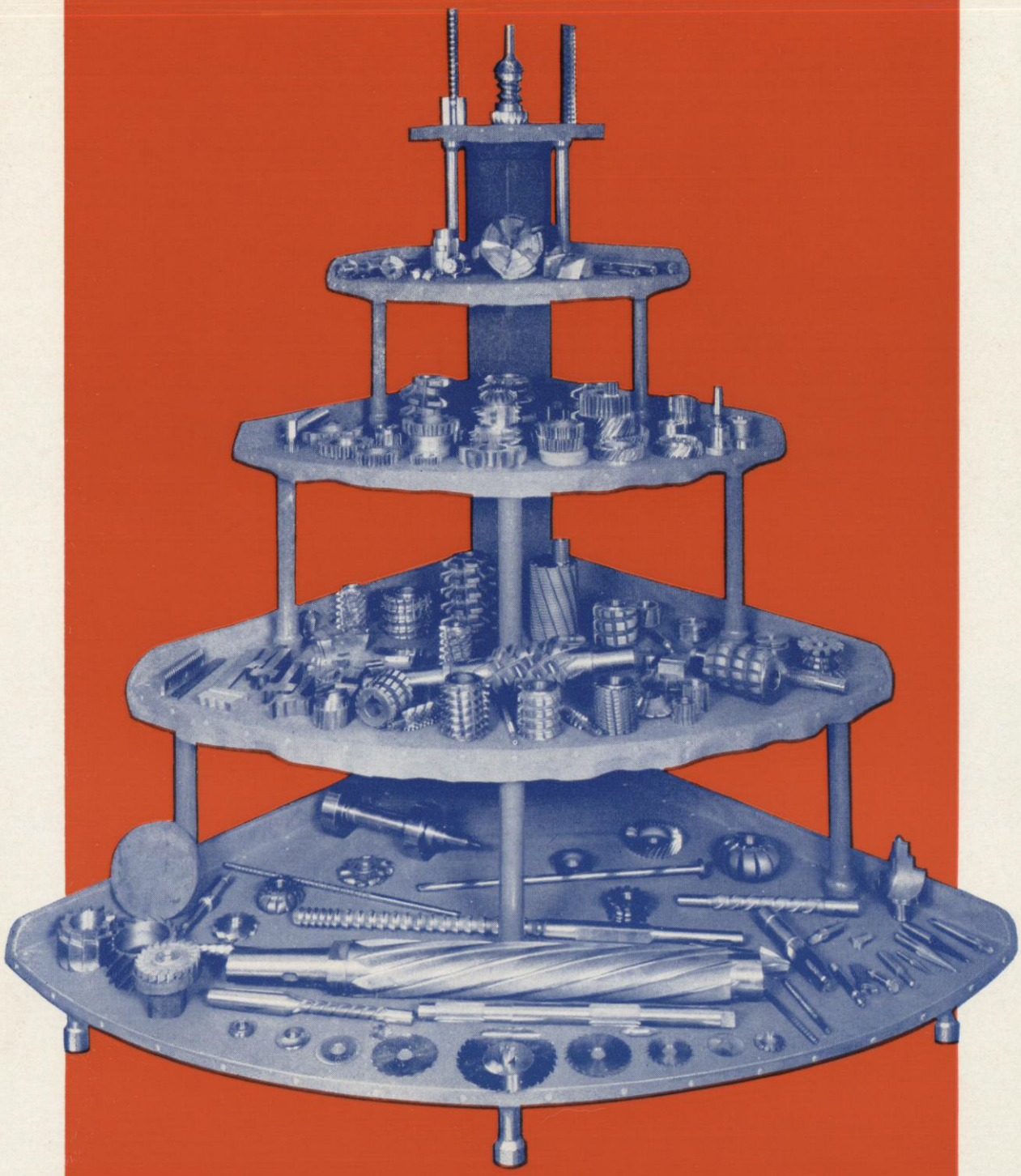
Side Milling Cutter



Shell End Mill

Involute Gear Cutter

Helical Worm Cutter
Gear and Spline Hobs
NEEDS OF THE NATION
Side Chip Slitting Saw
Inserted Blade End Mill
Interchangeable Counterbores
Dovetail Form Tool
Spiral Flute End Mill
Shank Type Shaper Cutter
Form Cutter



CUTTING TOOLS FOR EVERY REQUIREMENT

NATIONAL Tools CLEVELAND

Deferred charges include items to be charged to future operations. Regular tool expense is being charged to operations on the basis of one-twelfth of the deferred balance each month. Effective January 1, 1940, the Company changed its policy with respect to replacement tools and a portion of engineering expenses. These items were previously charged direct to profit and loss whereas they are now being charged to deferred tool expense and written off as stated above. Rock bit tool expense and development expense are being written off on the basis of fixed amounts per bit shipped. Additional comments in connection with deferred rock bit items are stated in a succeeding paragraph.

The accompanying balance sheet includes the following assets pertaining to or arising from the Company's rock bit business:

Current Assets:			
Inventories:			
Finished products		$2,495.11	
Work in process		6,034.13	$8,529.24
Investments and other assets:			
Accounts receivable:			
K. S. Richards Company	$5,180.37		
L. G. S. Tools, Inc	2,414.18		
	$7,594.55		
Less reserve	3,145.78	$4,448.77	
Investment-capital stock of			
L. G. S. Tools, Inc		5,000.00	9,448.77
Deferred charges:			
Deferred tool expense		$6,310.82	
Deferred development expense		4,655.89	10,966.71
TOTAL			$28,944.72

There was very little change in these accounts during the year 1940, and in reviewing the situation with an officer of the Company we were informed that, while the management is hopeful of substantial realizaton on these assets, the extent of such realization will depend on more vigorous sales effort and acceptance ot this product by the trade. We are of the opinion that a substantial reserve should be established on the records for these assets.

In our opinion, except that reserves should be provided for probable loss on ultimate realization on inventories, accounts receivable, investment and deferred charges pertaining to and arising from the rock bit business as stated, the accompanying balance sheet and related statements of profit and loss and surplus present fairly the position of The National Tool Company at December 31, 1940, and the results of its operations for the year, in conformity with generally accepted accounting principles which, except for change in the method of accounting for additions to machinery account and deferred tool expense as stated, have been applied on a basis consistent with that of the preceding year.

Ernst & Ernst

Certified Public Accountants

ASSETS

CURRENT ASSETS			
Cash:			
Demand deposits		$57,684.63	
Office working fund		153.05	$57,837.68
Accounts receivable:			
Trade accounts		$137,367.79	
Less reserve		952.09	136,415.70
Inventories-at lower of estimated cost or market:			
Finished products:			
Cutting tools	$27,369.35		
Machine	8,500.00	$35,869.35	
Work in process		78,231.67	
Raw materials:			
Steel stock	$46,395.70		
Forgings	16,720.60	63,116.30	
Manufacturing supplies		18,119.78	
Scrap steel		494.64	
		$195,831.74	
Less reserve		14,337.44	181,494.30 $375,747.68
INVESTMENTS AND OTHER ASSETS			
Miscellaneous deposits, receivables, etc.:			
Trade accounts receivable-not current		$ 8,045.58	
Less reserve		3,145.78	
		$ 4,899.80	
Other receivables, deposits, etc.		3,599.86	$ 8,499.66
Investments:			
L. G. S. Tools, Inc.—500 shares perferred stock and 5,000 shares common stock—at cost		$ 5,000.00	
S. A. Andre Citroen—3¼% debentures and profit sharing certificates		246.85	
Sundry securities—at nominal amounts		2.00	5,248.85
Accounts with officers ($682.78) and employees			1,864.48
Cash surrender value of life insurance		$ 4,643.92	
Less policy loan and accrued interest		3,885.49	758.43 16,371.42
PROPERTY, PLANT AND EQUIPMENT—at cost			
Land			$39,103.98
Buildings	$174,502.49		
Machinery, equipment, truck, etc.	275,761.67	$450,264.16	
Less reserves for depreciation		211,054.15	239,210.01
Appropriations in process			51,987.61 330,301.60
GOOD WILL, PATENTS, ETC.—nominal amount			1.00
DEFERRED CHARGES			
Deferred tool expense:			
Regular tools		$18,528.70	
Rock bit tools		6,310.82	$24,839.52
Deferred development expense:			
Rock bit tools		$ 4,655.89	
Cutting tools and machine		1,652.15	6,308.04
Unamortized debenture discount and expense			4,850.69
Prepaid insurance, taxes, etc.			4,302.79 40,301.04
			$762,722.74

LIABILITIES, CAPITAL STOCK AND SURPLUS

CURRENT LIABILITIES			
Accounts payable:			
Trade accounts	$ 88,710.34		
Wages and commissions	51,180.86		
Pay roll taxes	9,981.97		
Customers advance payments on orders	7,846.01	$157,719.18	
Accrued:			
Interest	$ 4,482.21		
Local taxes	3,750.00		
Federal capital stock tax	1,850.00		
Royalties, water rent, etc.	529.53	10,611.74	
Federal taxes on income—estimated:			
Provision for the year ended December 31, 1940		25,000.00	$193,330.92
FUNDED DEBT			
Convertible 6% sinking fund debentures (with warrants attached) maturing August 1, 1942:			
Outstanding		$198,000.00	
Less in treasury		19,000.00	179,000.00
PAYMENTS ON STOCK SUBSCRIPTIONS—EMPLOYEES			2,783.60
RESERVE			
For contingencies			2,835.00
CAPITAL STOCK AND SURPLUS			
Capital stock—Notes A, B and C:			
Common stock, par value $1.00 a share:			
Authorized 600,000 shares:			
Outstanding (including 3,680 shares in treasury)	206,628 shares $206,628.00		
Reserved for exchange of preferred and common shares of predecessor company	1,182 shares 1,182.00		
	207,810 shares	$207,810.00	
Surplus:			
Capital surplus	$102,990.96		
Earned surplus—since January 1, 1940	82,620.26		
	$185,611.22		
Less cost of 3,680 shares of common stock purchased for resale to employees	8,648.00	176,963.22	384,773.22
			$762,722.74

See notes on following page.

SURPLUS ACCOUNTS

THE NATIONAL TOOL COMPANY

Year ended December 31, 1940

CAPITAL SURPLUS

Balance at January 1, 1940		$ 74,324.57
Add:		
Excess of selling price over par value of:		
29,370 shares of common stock sold to underwriters at $2.00 a share	$ 29,370.00	
2,000 shares of common stock sold to Officer at $2.50 a share	3,000.00	
137 shares of common stock issues to employees at $2.50 a share	205.50	
	$ 32,575.50	
Recovery from underwriter of expenses in connection with the qualifying and issuing of stock—charged to this account in prior period	2,286.59	34,862.09
		$109,186.66
Deduct:		
Payments to effect cancellation of options on 27,000 shares of common stock	$ 5,000.00	
Expense in connection with shares sold to underwriters	1,195.70	6,195.70
BALANCE AT DECEMBER 31, 1940		$102,990.96

EARNED SURPLUS (SINCE JANUARY 1, 1940)

Balance at January 1, 1940	$ -o-
Net profit for the year	$ 82,620.26
BALANCE AT DECEMBER 31, 1940	$ 82,620.26

NOTES TO BALANCE SHEET

THE NATIONAL TOOL COMPANY

December 31, 1940

Note A—In addition to capital stock set forth as outstanding or reserved in the above statement, the Company has reserved 79,200 shares for conversion of debentures and 9,900 shares for conversion of stock warrants attached to debentures.

Note B—Option to purchase 3,000 shares of unissued common stock of the Company at $2.00 a share has been granted to an officer of the Company. The option to be exercised over a period of three years from January 1, 1941.

Note C—In connection with the underwriting of 41,000 shares of the capital stock of the Company during the year 1939, the Company has granted to the underwriter an option to purchase all or any part of 10,000 shares of the authorized but unissued common stock of the Company, at a price of $2.50 per share, at any time or from time to time during a period of three years from January 2, 1940, and at a price of $3.00 per share at any time or from time to time during a period of three years from January 2, 1943.

Note D—The Company has been named defendant in certain lawsuits involving the use of certain patents. It is the opinion of counsel for the Company that no material liability exists with respect to this litigation.

Ernst & Ernst

Certified Public Accountants